

Charitable Deduction Models
MTC Combined Reporting Subcommittee

General Facts:

Income/Expense	Parent	Corporation A	Corporation B	Corporation C	Total
Business Income	\$100 M	\$30 M	\$50 M	\$80 M	\$260 M
Nonbusiness Inc.	\$ 20 M	\$10 M	\$30 M	\$20 M	\$ 80 M
Charitable Cost	\$ 30 M				

Assume that charitable expenses are generally allowed to the extent of 10% of net income.

Model 1: Assign to the charitable deduction to the entity that incurred the cost based on that specific entity's total income on a separate entity basis, proportionate to class of income:

Business	\$100 M
Bus. Charitable	(\$10 M)
Nonbusiness	\$ 20 M
Nonb. Charit.	(\$ 2 M)
P Carryover	\$ 18 M

Effect: Charitable costs are isolated inside the entity that incurs it. Significant federal consolidated/state combined difference in terms of total allowable deduction.

Model 2: Assign first to the nonbusiness income of the entity that incurred the cost, and if any remains, treat as business expense of the group.

	Parent	Corporation A	Corporation B	Corporation C	Total
Nonbus. P	\$ 20 M				
Nonb. Charit.	\$ 2 M				
Business	\$100 M	\$30 M	\$50 M	\$80 M	\$260 M
Bus. Charitable	10 M	3 M	\$5 M	\$8 M	\$ 26 M
P Carryover	\$ 2 M				

Effect: Front-end loads expense to nonbusiness income. If charitable costs are relatively small, or nonbusiness income is relatively large, this could have the effect of not allowing a business expense for charitables for the rest of the group.

Model 3: Assign first to business income of the group (up to the 10% cap), and if any remains, treat as nonbusiness expense of the entity that incurs the cost.

	Parent	Corporation A	Corporation B	Corporation C	Total
Business	\$100 M	\$30 M	\$50 M	\$80 M	\$260 M
Bus. Charitable	\$ 10 M	3 M	\$ 5 M	\$ 8 M	\$ 26 M
Nonbus. P	\$ 20 M				
Nonb. Charit.	\$ 2 M				
P's Carryover	\$ 2 M				

Effect: Front-end loads expense to business income. If 10% of business income is sufficient to absorb all of the charitable costs, taxpayer gets no nonbusiness charitable expense.

Model 4: Assign proportionately to business and nonbusiness income of all unitary members.

	Parent	Corporation A	Corporation B	Corporation C	Total
Business	\$100 M	\$30 M	\$50 M	\$80 M	\$260 M
Nonbus.	\$ 20 M	\$10 M	\$30 M	\$20 M	<u>\$ 80 M</u>
Total					\$340 M
Allowed Deduction Ceiling (exceeds that paid)					\$ 34 M
Allowed Deduction (amount paid)					\$ 30 M
Distribution of deductible amount based on total business and nonbusiness income of the group:					
Business	\$100 M	\$30 M	\$50 M	\$80 M	
Charit. Distrib.	\$ 8.8 M ¹	\$ 2.6 M	\$ 4.4 M	\$ 7.1 M	\$22.9
Nonbus.	\$ 20M	\$10 M	\$30 M	\$20 M	
Charit. Distrib.	\$ 1.8 M	\$ 0.9	\$ 2.6 M	1.8 M	<u>\$ 7.1</u>
Total Charitable Exp.					\$ 30

Effect: Substantially increases the potential limitation base for charitable expenses, and causes nonbusiness charitable expenses to be deducted by an entity that itself incurred no charitable cost. Raises concerns about expenses of one legal entity being incurred to support a nonunitary activity of a separate legal entity. Under general federal law, only the entity that incurred an expense is entitled to it.

¹ E.g. 30 M allowed charitable costs x 100 M bus. income/\$340 total business and nonbusiness income of all members.

Model 5: Assign proportionately to business income and those specific members that both have nonbusiness expense and also have a charitable cost:

	Parent	Corporation A	Corporation B	Corporation C	Total
Business	\$100 M	\$30 M	\$50 M	\$80 M	\$260 M
Nonbus.	\$ 20 M				\$ 20 M
Total					\$280 M
10%					\$28 M
Business	\$100 M	\$30 M	\$50 M	\$80 M	\$260 M
Bus. Charitable	\$ 10 M	3 M	\$ 5 M	\$ 8 M	\$ 26 M
Nonbus. P	\$ 20 M				
Nonb. Charit.	\$ 2 M				
P's Carryover	\$ 2 M				

Effect: Appears to have a similar effect as above, but at the extremes, can produce its own irregularities: See next page.

Model 5 Variation: Assume same facts except Parent contributes \$1 M and Corporation A Contributes \$29 M, and Parent has \$70 million in nonbusiness income, and Corporations B and C have none.

Income/Expense	Parent	Corporation A	Corporation B	Corporation C	Total
Business Income	\$100 M	\$30 M	\$50 M	\$80 M	\$260 M
Nonbusiness Inc.	\$ 70 M	\$10 M			\$ 80 M
Charitable Cost	\$ 1 M	\$29 M			\$ 30 M
Business	\$100 M	\$30 M	\$50 M	\$80 M	\$260 M
Nonbus.	\$ 70 M	\$10 M			<u>\$ 80 M</u>
Total					\$340 M
10%					\$34 M
Limit to amount paid					\$30 M

Distribution of Expense:

	Parent	Corporation A	Corporation B	Corporation C	Total
Business	\$100 M	\$30 M	\$50 M	\$80 M	
Charit. Distrib.	\$ 8.8 M ²	\$ 2.6 M	\$ 4.4 M	\$ 7.1 M	\$22.9 M
Nonbus. P	\$ 70 M	\$10 M			
Nonb. Charit.	\$ 6.2 M	\$.9 M			<u>\$ 7.1 M</u>
					\$30.0

Effect: Although Parent only paid \$1 M in actual charitable cost, it adds \$70 of nonbusiness income to the total pool. This effect could also occur if only a single dollar of charitable cost was contributed by P. In addition, Parent obtains a charitable deduction of \$2 M against its nonbusiness income, \$1 M of which was attributable to a cost incurred by Corporation A.

² E.g. 30 M costs x 100 M bus. income/\$340 total business and nonbusiness income of all members.